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No.

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1986

MICHAEL M. RAND, JOHN COSTELLO, STEVEN J. COSTELLO, GREGORY T. FRESE, EDWARD LAVIN, PETER A. MILANO and VINCENT F. SERVELLO,

Petitioners,

vs.

ANACONDA-ERICSSON, INC., ERICSSON, INC., L.M. ERICSSON TELEPHONE COMPANY, NORDIC AMERICAN BANK, CITIBANK, N.A., PRICE-WATERHOUSE & CO., SULLIVAN & CROMWELL, RICHARD HOWE, RICHARD G. LYON, L. STANTON TOWNE, TELECOM EQUIPMENT CORP., and STEPHEN R. COHEN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED FOR REVIEW

1. Whether petitioners' attorneys, prior to issue being joined and without a hearing on the matter, were improperly enjoined by the District Court for simply prosecuting petitioners' meritorious claims?

2. Whether petitioners' attorneys, prior to issue being joined and without a requested evidentiary hearing, were improperly sanctioned by the District Court ($20,000 fine) on the ground that instead of opposing respondents' summary judgment motion, petitioners' attorneys should have agreed to the entry of judgment against their clients in order to save respondents the cost and fees of preparing additional papers?

3. Whether petitioners themselves were improperly enjoined from prosecuting their claims on the basis of prior litigation in which they never participated either as parties or the privies of any party?

4. Whether the Court of Appeals, in affirming the entry of an injunction against petitioners and petitioners' attorneys, restraining them from prosecuting both petitioners' claims and those of the shareholders petitioners sought to represent, has improperly denied petitioners and their attorneys access to the courts and has so far sanctioned a departure from the accepted and usual course of judicial proceedings as to call for the exercise of this Court's power of supervision?

5. Whether the action taken by the Court of Appeals in affirming the entry of an injunction and the award of sanctions against piaintiffs' attorneys is in conflict with this Court's decision in *Roadway Express, Inc. v. Piper*, 447 U.S. 752 (1980), entitling a sanctioned attorney to traditional procedural due process safeguards?

6. Whether the Second Circuit's determination that petitioners lacked standing to sue under Section 10(b) and Rule 10b-5 for the injury they sustained as a result of the publication by respondents of a deceptive press release across the Dow Jones broad tape—which collapsed the price of petitioners' stock—is in conflict with decisions of other federal courts of appeal on the same subject?

7. Whether in view of this Court's decision in *Blue Shield of Virginia v. McCready*, 457 U.S. 465 (1982), the Court of Appeals erred in holding that no shareholder of a corporation, no matter how direct the injury he personally sustained as a result of a defendants' anticompetitive activities, can ever "as a matter of law" have standing to sue under the federal antitrust laws?

8. Whether the Court of Appeals erred in holding that respondents' conduct in this case, including sending a detailed written proposal to the corporation in which petitioners were shareholders, announcing defendant Ericsson's intention to purchase a majority of that corporation's stock—a proposal that expressly required the approval of the corporation's shareholders—did not constitute a "tender offer" within the meaning of Section 14(e) of the Williams Act?

9. Whether in view of this Court's ruling in *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. ____, 105 S. Ct. 3275 (1985), petitioners, as shareholders, have standing to sue under the RICO statute for injury sustained as a result of having been duped by respondents' fraudulent press release into selling their stock?

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The petitioners respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, rendered in this action on July 9, 1986.

OPINIONS BELOW

The memorandum and order dated August 30, 1985 by the District Court for the Eastern District of New York (Neaher, J.) is reported at 623 F. Supp. 176 (E.D.N.Y. 1985) (*see* Appendix A). The opinion of Circuit Judge Winter of the United States Court of Appeals for the Second Circuit, decided July 9, 1986, is reported at 794 F. 2d 843 (2nd Cir. 1986) (*see* Appendix C).

JURISDICTION

The decision of the Court of Appeals for the Second Circuit was made and filed on July 9, 1986. This decision affirmed the District Court's dismissal of the action and imposition of the sanction of an injunction against petitioners and their counsel. Petitioners' petition for a rehearing en banc was denied by order filed September 9, 1986 (*see* Appendix D). The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254(1).

STATEMENT OF THE CASE

A. Nature of the Case

Petitioners who are shareholders in Teltronics Services, Inc. (Teltronics) a bankrupt corporation, allege an anticompetitive conspiracy by respondents to seize the assets of Teltronics by forcing that company into bankruptcy by means of, among other things, the publication, during negotiations with respondent Ericsson for Teltronics' acquisition—of misleading and deceptive press releases across the Dow Jones broad tape which duped Teltronics' shareholders into selling their shares and thereby collapsed the price of petitioners' stock.

Petitioners allege that the Ericsson respondents made clear in a detailed written proposal their intention of acquiring a

controlling stock interest in Teltronics, negotiated with Teltronics' shareholders to that end, and, in conjunction with their lawyers, established a precise agenda for Teltronics' acquisition. When these negotiations began to falter, however, respondents were determined to take over Teltronics through bankruptcy proceedings. In order to drive down the price of Teltronics' stock and, ultimately, to ensure that Teltronics would not escape bankruptcy by using its unissued stock to obtain additional capital through a private stock sale or through a merger or acquisition, respondents created a fictitious bank default—using a "captive" bank, the Nordic Bank, for that purpose—and issued word of that default over the Dow Jones newswire. Instantly after the press release was published, the price of Teltronics stock plummeted, and within days, as a result of the release, Teltronics lost millions in signed sales contracts, owed millions in pledged accounts payable and lost the rents of thousands of equipment leases. As the result of the press release's announcement of pending attachment proceedings, the banks that handled Teltronics' payroll and other accounts also offset over $1,000,000 in deposits. Thereafter, Teltronics' creditors, led by respondent Ericsson, forced Teltronics into bankruptcy.

On the same day that the Ericsson respondents published their press release, Ericsson established its so-called "New York Division" under the direction of two of its senior officers, to sell telephone equipment directly to Teltronics' customers. According to the sworn testimony of the manager of Ericsson's New York Division, Ericsson set up a "boiler room" operation on the same date, an operation which continued throughout the course of Teltronics' bankruptcy proceedings, for the specific purpose of cutting off Teltronics' cash flow, closing down Teltronics' banking relationships, and stripping the bankrupt estate of its assets.

B. The Facts

In 1970, Teltronics was incorporated in New York State and

began operations in New York City as a marketing organization for the sale of telephone equipment. In 1973 Teltronics became a public corporation with its shares traded nationally in the over-the-counter market. The following year, Teltronics became an Ericsson distributor.[1] Ericsson confined its financing of Teltronics to the informal guaranteeing of bank loans, principally with respondent North American Bank (Nordic), a small Ericsson affiliate not licensed as a commercial bank, and with respondent Citibank, a New York City bank. Ericsson arranged with Nordic and Citibank to lend money to Teltronics which Teltronics would use to buy telephone equipment from Ericsson.

Teltronics experienced great success in the marketing of telephone equipment and, as a result, became an attractive candidate for tender offer bids. On June 15, 1978, Gerald Tsai, as chairman of Associated Madison Companies, made an unsuccessful bid to acquire a minimum of 20% of Teltronics' outstanding stock at $8 a share. In October of the same year, the Loral Corporation announced its intention of acquiring Teltronics. The Ericsson respondents, in response, retained the law firm of respondent Sullivan & Cromwell to fend off the Loral takeover attempt and pledged $4,000,000 in additional money to Teltronics in the event such financing should prove necessary.

Following the defeat of Loral's tender offer bid, Ericsson revealed its own tender offer plan to Teltronics, through which Ericsson hoped to acquire a 50% controlling interest in Teltronics

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1. In 1974, Ericsson took over its Miami distributor after the latter defaulted on its credit obligations to Ericsson. During the same year, Ericsson also took over the business of its Boston distributorship after the latter two went into default on its trade account with Ericsson in 1976. Ericsson's Philadelphia distributor also fell behind in its payment of its trade account and Ericsson took over its entire business. By 1977, Teltronics was the only Ericsson distributor in the United States not owned by Ericsson and represented over two-thirds of Ericsson's United States telephone equipment sales.

by having the latter acquire Ericsson's Boston and Philadelphia subsidiaries.[2] On November 15, 1978, Ericsson's board of directors in Stockholm approved the takeover of Teltronics—as outlined in a Sullivan & Cromwell letter to Teltronics, dated December 5, 1978, and a precise schedule was set up for the acquisition of Teltronics, including a proposed filing under Hart-Scott-Rodino, the submission of the requisite proxy materials to the SEC, and, finally, a Schedule 13(d) filing under the Williams Act.[3] Negotiations between the two companies continued through January and February of 1979, with Teltronics demonstrating no enthusiasm for the terms of Ericsson's tender offer and Ericsson, on the other hand, fearful that Teltronics was "looking for other possible buyers."

Teltronics at this time owed the Nordic Bank an interest payment of $230,000 which was shortly to become due. Since Teltronics' year-end cash position was over $1,000,000 and Ericsson's tender offer was pending, Ericsson agreed to a deferral of the payment to March 31, 1979, directing Nordic in writing that if Teltronics did not make the payment, Ericsson would do so. Ericsson deposited $250,000 with Nordic for that purpose.

On February 28, 1979, however, respondent Sullivan & Cromwell secretly met with the president of the Nordic Bank and

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2. At the same time, Ericsson began demanding that Teltronics shut down its Boston office which Teltronics had recently opened in head-to-head competition with Ericsson's Boston subsidiary. Ericsson indicated to Teltronics that unless it ceased competing with Ericsson in Boston, Teltronics would receive no further financing of sales in that area.

3. Ericsson proposed to purchase 750,000 shares of Teltronics' stock for a consideration that would include both cash and the total assets of Ericsson's subsidiaries in Boston and Philadelphia. In addition, Ericsson would have an option to purchase 30,000 additional shares and a right of refusal on another 288,644 shares. If the option and the right of first refusal were exercised, Ericsson would own a majority of Teltronics' outstanding stock.

directed him not to credit Teltronics' account with the $250,000 then on deposit with the bank because Ericsson wanted a "technical" default on the interest payment, which under the terms of Nordic's loan agreement with Teltronics would result in an acceleration of the entire $8,000,000 principal owed by Teltronics to Nordic and Citibank.[4] February 28, 1979 was a Wednesday, and under the Nordic loan agreement, Teltronics had a two-day grace period, which meant that even assuming February 28th was the date the payment was allegedly due, the earliest date for declaring such a "default" was, due to the intervening weekend, Monday, March 5, 1979. On the latter date, the necessary documents having been put together over the weekend by Ericsson and its attorneys, together with Nordic and Citibank, there having been no communication with Teltronics in the meanwhile—the banks, based on cross-default provisions in their loan agreements, declared Teltronics in default on its interest payment and accelerated the entire amount of their loans. Respondent Sullivan & Cromwell, with previously prepared motion papers moved to attach Teltronics' equipment leases—valued at over $9,000,000—and issued a press release on Ericsson's behalf over the Dow Jones broad tape concerning Teltronics' alleged default. The release, as intended by respondents, caused the price of Teltronics' stock to plummet immediately from $9 to $1 a share, causing a suspension of trading in Teltronics' stock. The stock never rose above $1 again.

C. The Beagan Action

On April 12, 1983, Teltronics and Edward Beagan, Teltronics' chairman and president, commenced an action in the District Court against the Ericsson defendants. On May 11, 1983 the Ericsson

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4. The details of the meeting at the Nordic Bank were recorded in a diary kept by Lars Radberg, Nordic's president. The diary was produced during bankruptcy discovery proceedings.

defendants moved—prior to issue being joined—for summary judgment dismissing the complaint. A year later, on May 11, 1984, the District Court granted defendants' motion. *Teltronics Services Inc. v. Anaconda-Ericsson, Inc.*, 587 F. Supp. 724 (E.D.N.Y. 1984). The court dismissed all of Teletronics' claims on the ground that, although Teltronics' bankruptcy trustee had never sued under the federal securities, antitrust or RICO statutes, all such claims had nonetheless been disposed of when Teltronics' claim for equitable subordination against Ericsson had been settled—for approximately $50,000—in the bankruptcy court. Plaintiff Beagan's federal and common law shareholder claims were also dismissed[5] and he was enjoined, *sua sponte*, by the District Court from "further litigating claims belonging to Teltronics." No hearing was held on the injunction prior to its entry.

Plaintiffs moved for reargument. Shortly thereafter a conference was held at which time the court indicated that it intended to deny plaintiffs' reargument motion. When advised that plaintiffs planned to take an appeal, the court stated that, in its judgment, an appeal would be beneficial both to the court and to the parties in the case. The court indicated that it welcomed "guidance" from the Court of Appeals on the matter.

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5. Plaintiff Beagan's Rule 10b-5 claim was rejected on the ground that, although the court agreed that in certain circumstances a bankruptcy might constitute a "forced sale" for purposes of Section 10(b), the nexus between Ericsson's press release and the "sale" failed to meet the "in connection with" requirement of the federal securities laws. The court neglected to consider plaintiff's claim under the Williams Act, however. Beagan's RICO claim was dismissed on the basis of a 3-year New York statute of limitations. His federal antitrust claim was dismissed on the ground that although Beagan might have suffered injury in fact, defendant's anticompetitive conspiracy was aimed at Teltronics and therefore only Teltronics had standing to sue. Beagan's common law claims were dismissed on the basis of a hearsay affidavit by one of defendant's attorneys which simply stated that the attorney had consulted with his clients and the latter had denied any liability.

Plaintiffs' motion for reargument was thereafter denied. In its decision, the District Court never mentioned any perceived impropriety in plaintiff Beagan's taking an appeal from the dismissal of his individual claims. On the appeal itself, the Ericsson defendants submitted a 50-page brief but never mentioned any alleged violation by plaintiff Beagan in appealing the dismissal of his shareholder claims.

The Court of Appeals did not affirm the District Court on *any* of the grounds the latter court had relied on in dismissing plaintiff Beagan's claims, but instead relied on a different ground, *i.e., res judicata*. Beagan, the court said, as Teltronics' president, was a "privy" of Teltronics in prior adverse litigation affecting that company and his claim was therefore barred when Teltronics' claims were settled in the bankruptcy court. The court took care to point out, however, that the *res judicata* effect of its ruling was binding only on plaintiff Beagan.[6]

D. The Instant Action

Petitioners filed the instant shareholder class action on September 23, 1983. Neither Beagan nor Teltronics was a party to the suit and none of the shareholders-petitioners had ever instituted an action against any of the respondents to recover

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6. The Court of Appeals said:

> We therefore hold that Beagan is bound by the several prior decisions adverse to Teltronics. *We take care to point out that we hold only that Beagan*, as an individual participant and leader at the epicenter of the previous corporate litigation, and a potentially substantial beneficiary should these suits have a positive outcome, *is bound by the adverse decisions as to the cause of action asserted in the previous suits."* (Emphasis added.) *Teltronics Services, Inc. v. Anaconda-Ericsson, Inc.*, 762 F. 2d 185, 193 (2d Cir. 1985).

damages for their stock loss. The action was commenced months before a summary judgment motion was filed in the *Beagan* action. The District Court's order dismissing the *Beagan* case is dated May 11, 1984, eight months after the institution of petitioners' shareholder lawsuit.

On November 15, 1983, respondemts—before issue was joined—moved for summary judgment. Before petitioners had an opportunity to serve opposing papers, however, the District Court directed the summary judgment motion be held in abeyance pending outcome of the appeal in the *Beagan* case.

Immediately upon receipt of the Second Circuit's decision in the latter case on March 22, 1985, the respondents requested a conference with the District Court in the instant case. during that conference, respondents asked for, and received, permission from the court to file supplemental papers in connection with their outstanding summary judgment motion. Respondents were not responding to any papers that petitioners had submitted—petitioners had submitted none—and petitioners were not the cause of respondents' submission. Respondents were directed by the court to file their supplemental papers within 30 days. Petitioners were given 30 days thereafter to respond.

By memorandum and order dated August 30, 1985, the District Court granted respondents' motion for summary judgment. *Rand v. Anaconda-Ericsson, Inc.*, 623 F. Supp. 176 (E.D.N.Y. 1985). In doing so, the court also granted respondents' motion for sanctions against petitioners' attorneys—made two years before—and relating to the *commencement* of the action, on the following grounds:

A. That petitioners' attorneys, despite the District Court's injunction against plaintiff Beagan in the *Beagan* case (a separate action) prohibiting him from litigating claims "belonging to

Teltronics," had nonetheless filed an appeal on Beagan's behalf in that case without first seeking the approval of the District Court;

B. That petitioners' attorneys, despite the existence of the same injunction against Beagan (not, as noted, a party to the instant litigation), allegedly made "continued attempts" to litigate claims belonging only to Teltronics "by substituting other Teltronics' shareholders" in Beagan's stead and that this was "contrary to the order of the Court of Appeals" in the *Beagan* case;[7]

C. That petitioners' attorneys had sought to "rehash" what had been reviewed in prior cases;[8]

D. That opposition by petitioners and their attorneys to respondents' summary judgment motion was improper since the Second Circuit's decision in the *Beagan* action should have communicated the "frivolity" of any such opposition to "any reasonable attorney."

Having awarded monetary sanctions against petitioners' attorneys, without a hearing, the District Court then entered a further injunction—again without a hearing (although a hearing was requested)—restraining petitioners (and their attorneys) from pursuing "any new or pending litigation" which "concerns Teltronics Services, Inc."

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7. The sense of the District Court's opinion is that petitioners had commenced the present action only after the *Beagan* action was dismissed. This is, of course, untrue.

8. None of petitioners were ever a party or the privies of any parties to prior litigation involving Teltronics. Moreover, the District Court itself conceded that *res judicata* was not an issue in the case. *Rand v. Anaconda-Ericsson, Inc.*, 623 F. Supp. at 189.

Petitioners moved for reargument requesting a specification of the findings of "bad faith" litigation leveled against them and asked for the opportunity to be heard at an evidentiary hearing. On December 2, 1985, the court denied petitioners' motion, stating that while nothing in the court's decision permitted the inference that petitioners' attorney had "solicited" Teltronics' shareholders to sue respondents, *i.e.*, after the court had dismissed the *Beagan* lawsuit, petitioners' attorneys, rather than opposing respondents' summary judgment motion, should have agreed to the entry of judgment against their clients thus saving respondents "the costs and fees of preparing additional papers."[9]

The District Court rejected the argument that petitioners' attorneys had been denied due process and held they were not entitled to an evidentiary hearing, since according to the court, the court's finding of "bad faith" rested upon "undisputed activities".

E. Court of Appeals Determination

On appeal the Second Circuit affirmed the District Court's judgment dismissing the complaint. It affirmed the entry of an injunction against petitioners and their attorneys on the ground that petitioners—who were suing for the first time—were allegedly engaged in "repetitive" litigation.

Petitioners' petition for rehearing and a rehearing en banc was summarily denied.

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9. It should be noted that no additional papers were required to be filed by defendants under any rule. Defendants' summary judgment papers were already on file. Plaintiffs, on the other hand, had submitted no papers at all and it is difficult to see how the case could have been put in an intelligible posture for appeal if no papers were submitted by plaintiffs. Rule 56, Fed. R. Civ. P., opens the record and plaintiffs were required to submit whatever evidence they had in opposition to defendants' motion.

REASONS FOR GRANTING THE WRIT

I.

THE ENTRY OF AN INJUNCTION AGAINST PETITIONERS AND THEIR ATTORNEYS FOR ALLEGED "BAD FAITH" LITIGATION WAS AN IMPROPER EXERCISE OF THE DISTRICT COURT'S INHERENT POWERS.

A. Petitioners' Attorneys Right to Notice and a Hearing

The District Court entered an injunction against petitioners and their attorneys, *sua sponte*, and without notice or a hearing allegedly pursuant to the exercise of the court's inherent powers to punish counsel for alleged "bad faith" litigation. *Alyeska Pipeline Co. v. Wilderness Society*, 421 U.S. 240 (1975). Petitioners and their attorneys, prior to their being enjoined by the court, were, they believe, entitled to an evidentiary hearing concerning the issue of their alleged "bad faith" and that the court's failure to afford them such a hearing was a denial of due process. In *Roadway Express, Inc. v. Piper*, 447 U.S. 752 (1980), this Court affirmed the entitlement to notice and an opportunity to be heard attendant on the assessment of attorneys' fees for counsel's failure to comply with various requirements during the course of an action. In a detailed discussion of the authority for, and the predicates to, the imposition of sanctions, this Court said:

> "Like other sanctions, attorneys' fees certainly should not be assessed lightly or without fair notice and an opportunity for a hearing on the record". *Id.* at 767.

Several Circuits relying on *Road Express*, have also emphasized that a sanctioned party or attorney is entitled to

procedural due process safeguards. In *Miranda v. Southern Pacific Transp. Co.*, 710 F. 2d 516 (9th Cir. 1983), the District Court imposed sanctions on counsel for failing to comply with a local rule of the court concerning pretrial documents. The imposition of sanctions was reversed, the Circuit Court holding that such authority could not be exercised without the procedural protections of prior notice and an opportunity to prepare a defense and a separate hearing addressed to the imposition of sanctions. *Id.* at 522, 523, n. 12.

Accord: In re Cardona Gonzalez, 726 F. 2d 16, 20 (1st Cir.), *cert. denied*, 104 S. Ct. 2154 (1984) (District Court's imposition of sanctions is appropriate only if an attorney was "given fair notice and a hearing on the record"); *Gamble v. Pope & Talbot, Inc.*, 307 F. 2d 729, 731 (3rd Cir.), *cert. denied*, 371 U.S. 888 (1962) (monetary sanctions against lawyers without affording them procedural safeguards violates due process).

B. Standard for Award of Sanctions Under "Bad Faith" Exception

Although the Court of Appeals briefly refers in its opinion to Rule 11, Fed. R. Civ. P., in connection with the award of sanctions against petitioners' attorneys, the award was actually made by the District Court under the "bad faith" exception to the American Rule. Under the rationale developed in the Second Circuit, to award fees under this bad faith exception a court must find "clear evidence" that the offending party's claims were (a) "entirely without color" and (b) made "for reasons of harassment or delay or for other improper purposes". *Sierra Club v. U.S. Army Corps of Engineers*, 776 F. 2d 383 (2d Cir. 1985). The test is conjunctive and neither meritlessness nor improper purpose alone will suffice. *Colombrito v. Kelly*, 764 F. 2d 122, 133 (2d Cir. 1985).

The District Court did not find that the instant action was "without color" at the time the action was commenced. What

the court held was that the action allegedly became so only after the Second Circuit dismissed Edward Beagan's claims in the *Beagan* case on *res judicata* grounds. That decision, the District Court indicated, made the further prosecution of the instant case frivolous. Petitioners' attorneys should then have recognized the sheer hopelessness of their clients' cause and should not have opposed respondents' outstanding motion for summary judgment (held in abeyance by the District Court pending the Second Circuit's decision in *Beagan*) but should instead have consented to entry of judgment against their clients without submission of any opposition papers. Petitioners' attorneys believe the District Court was wrong in so holding.

Moreover, neither the record below nor the opinions of the District Court or the Court of Appeals, respectively, reveals any improper purpose on the part of petitioners' attorneys in opposing respondents' motion for summary judgment. Petitioners' attorneys did not—and do not—believe that the grounds set forth by the District Court in the *Beagan* case represents existing law. The basis for petitioners' opposition to the motion was *clearly* not frivolous. In addition, many of the underlying legal bases relied on by the District Court in *Beagan* had already changed, *e.g.*, this Court had overruled the Second Circuit in the *Sedima* case. Petitioners' submission in opposition to the summary judgment motion was strictly in accordance with the District Court's scheduling order and was made only after a conference with that court, at which time the District Court never indicated that petitioners' opposition to respondents' summary judgment motion was in any way inappropriate or improper.

Nonetheless, despite the fact that the petitioners in the instant litigation are not the same parties involved in any prior litigation involving Teltronics—a fact the Court of Appeals apparently concedes (30a)—and despite the fact that the same court in the *Beagan* action, 762 F. 2d 185, 193 (2d Cir. 1985), expressly ruled

that only Edward Beagan was barred by the doctrine of *res judicata* from pursuing his shareholder claims in that case ("We take care to point out that we hold only that Beagan . . . is bound by the adverse decisions as to the cause of action asserted in the previous suits"), the Court of Appeals nonetheless affirmed the entry of an injunction against petitioners and their attorneys on the ground that they are allegedly engaged in "repetitive" litigation.

Petitioners are not engaged in repetitive litigation. This is the first time these petitioners have ever been in court seeking damages both for themselves and for the other defrauded Teltronics' shareholders. The District Court itself expressly conceded that *res judicata* is not an issue in the case. It therefore seems highly unfair—and contrary to the facts—for the Court of Appeals, in a critical manner to state that petitioners, who are the victims of respondents' wrongdoing, believe that "if at first you don't prevail sue, sue again" (39a). The petitioners have sued once, and only once, for the damages they sustained at Ericsson's hands.[10] The facts in the record fully support the validity of the allegations in the complaint. Nonetheless, when not even an answer had been filed in the the District Court, petitioners' complaint was summarily dismissed, their attorneys enjoined and fined $20,000 (with a second "judgment" entered against them personally for such amount), and petitioners accused of having wrongfully come to court in the first place.

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10. Petitioners John and Steven Costello, Lavin Milano and Servello are all suing for the first time. While petitioners Rand and Frese objected, as creditors, to approval of Teltronics' bankruptcy settlement, they too are suing for the first time for damages for the injury they sustained as shareholders.

II.

PETITIONERS' CLAIMS IN THE DISTRICT COURT WERE WARRANTED BY EXISTING LAW OR A GOOD FAITH ARGUMENT FOR THE EXTENSION, *MODIFICATION OR REVERSAL OF EXISTING LAW.*

Contrary to the assertion of the Court of Appeals in its opinion, the theory of petitioners' case is not—and never was—that respondents "led Teltronics to believe that it need not make an interest payment" allegedly due at the end of February 1979 (28a). Any such claim, standing alone, would simply amount to common law misrepresentation and the claims would belong to Teltronics not to petitioners. The thrust of petitioners' complaint is that Ericsson and its lawyers secretly visited the Nordic Bank and deliberately created a fictitious default and announced that default across the Dow Jones broad tape to collapse the price of petitioners' stock and thereby to force Teltronics into bankruptcy. Hence, any finding by Bankruptcy Judge Parente in Teltronics' adversary hearing in the bankruptcy court—to the effect that the respondents "never represented to Teltronics that Teltronics would not be required to make a timely payment of the interest due to Nordic"—even if such a finding were binding on the petitioners,[11] is plainly irrelevant to the legal validity of petitioners' federal securities act, RICO and antitrust claims.

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11. A bankruptcy court is not, of course, an Article III court and even if petitioners were parties to Teltronics' bankruptcy proceedings (which there were not) the findings of the bankruptcy court would arguably not, under rulings in the Second Circuit, have *res judicata* effect in the District Court. *See, e.g., Lyons v. Westinghouse Electric Corp.*, 222 F. 2d 184, 189 (2d Cir. 1955), *cert. denied.*, 350 U.S. 625 ("The grant to the district courts of exclusive jurisdiction over [federal antitrust actions] should be taken to imply an immunity of their decisions from any prejudgment elsewhere").

A. Section 10(b) Claim

In its summation of the facts in the case, the Court of Appeals noted that the publication of respondents' press release across the Dow Jones newservice "discouraged corporate suitors," made it impossible for Teltronics to secure financing and directly resulted in Teltronics' bankruptcy (32a). The court's opinion fails to emphasize, however, that respondents' release was designed to and did in fact, instantly depress the price of petitioners' publicly traded stock. It is the latter circumstance which forms the basis of petitioners' Section 10(b) claims, *i.e.*, the deception of Teltronics' shareholders causing the price of their stock to fall from $9 to under $1 a share in a single trading day.[12] Since respondents' conduct was part of a "single fraudulent scheme" to drive Teltronics into bankruptcy, *Alley v. Miramon*, 614 F. 2d 1372, 1378 (5th Cir. 1980), the policies underlying Section 10(b) and Rule 10b-5 require a holding that respondents' fraud on the securities markets was also a fraud on petitioners "in connection with" the forced sale of their stock. As the Second Circuit stated in *Vine v. Beneficial Financial Co.*, 374 F. 2d at 635,

> "In essence,—(defendant) by deceiving A can cause B to become a seller. When this is all part of a single fraudulent scheme and that scheme is a classic example of deception of an entire class of Class A stockholders, as alleged here, we think the policies of Section 10(b) and Rule 10b-5 justify holding that fraud on A is 'in connection with' the forced sale by B."

In other words, Teltronics' bankruptcy did not "trigger" an

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12. The damage was done to the value of petitioners' stock, deliberately and immediately. However, this damage was clearly not a measure (or mirror image) of any damage done to Teltronics at the same time.

otherwise "non-existent" Section 10(b) claim (35a). The federal securities laws did not come into play "only when a bankruptcy occurr(ed)," as the Court of Appeals asserts (34a). The securities laws immediately came into play when respondents sent their press release across the Dow Jones newswire and fraudulently depressed the price of Teltronics' shares. As a result, all of those Teltronics' stockholders who sold their shares in reliance on Ericsson's deceptive release had a right to sue for the loss they sustained as a result of respondents' patently illegal act. Since the issuance of the press release was also part of a "single fraudulent scheme" to drive Teltronics into bankruptcy, however, the rationale of the *Vine* case dictates that petitioners also have standing to sue as "forced sellers". The forced sale doctrine clearly relates only to petitioners' standing to sue for securities fraud, not the "existence" of that fraud under the federal securities laws.

Hence, petitioners' fraud claim is plainly not "virtually limitless," as the Court of Appeals states (34a). Nor does application of the forced sale doctrine to bankruptcy proceedings convert "any" fraudulent conduct resulting in a corporate bankruptcy into securities fraud, as the Court of Appeals also apparently believes (34a). On the contrary, the conduct at issue must not only be "in connection with" the purchase or sale of securities, but the fraud must also play a substantial role in actually *causing* the bankruptcy. *See Ingenito v. Bermec Corp.*, 376 F. Supp. 1154, 1177 (S.D.N.Y. 1974).

The forced sale doctrine cannot, therefore, as the Court of Appeals claims, encompass "misrepresentations about the nature of a competitor's goods" or the "use of industrial spies,"[13] (34a),

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13. This is an apparent reference to petitioners' inclusion in the record (in support of their RICO claims) of Ericsson's uncontested conviction of violation of the Export Control Act. Ericsson's division had fraudulently acquired

(Cont'd)

precisely because such conduct, without more, has nothing at all to do with securities fraud, *i.e.*, fraud relating to either the investment value of stock or the integrity of the capital markets generally. *Angelastro v. Prudential-Bache Securities, Inc.*, 764 F. 2d 939, 946 (3rd Cir. 1985). Nor is such conduct part of "a single fraudulent scheme" to drive a corporation into bankruptcy, as is the case here.

The Court of Appeals' additional determination that the application of the forced sale doctrine is "limited to" securities transactions resulting in an "intra-firm freeze-out" of one group of investors by another, is also plainly wrong. In *Crane Co. v. Westinghouse Air Brake Co.*, 419 F. 2d 787 (2d Cir.), *cert. denied*, 400 U.S. 822 (1969), for example, the Second Circuit itself applied the forced sale doctrine to a corporation which, after its tender offer was defeated and the target company had merged with a third corporation, faced the threat of antitrust action if it did not part with the interest it had acquired in the target. While the corporation was still able to sell its stock in the open market, the Court of Appeals held that the corporation nonetheless had no practical alternative but to sell the shares it had already acquired. The *Crane* case obviously did not involve the circumstance—now demanded by the Court of Appeals in the present case as a condition precedent to conferring forced seller status upon the petitioners—where securities holders are "forced" by other investors "in the same firm" to trade their investments for cash (34a). *See also, Dudley v. Southeastern Factor & Finance Co.*, 446 F. 2d 303, 307 (5th Cir. 1971) ("*Vine's* informing principle, carried forward in *Crane*, is that a shareholder should

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(Cont'd)

(and then sold to the Soviet Union) a super secret air-breathing radar system, and maintained it under contract during the period up through the date of conviction. This Court in the *Sedima* case did away with the requirement of actual convictions under the RICO statute, however.

be treated as a seller when the nature of his investment has been fundamentally changed from an interest in a going enterprise into a right solely to a payment of money for his shares"); *accord, Travis v. Anthes Imperial, Ltd.*, 473 F. 2d 515 (8th Cir. 1973) (tender offer); *Falls v. Fickling*, 621 F. 2d 1362 (5th Cir. 1980) (judgment debtor); *Garner v. Pearson*, 374 F. Supp. 591 (M.D. Fla. 1974) (liquidators of bank).

Finally, the Court of Appeals' further justification of its ruling on the ground that if petitioners are allowed to sue Ericsson under the federal securities laws "a major corporate asset," *i.e.*, the claim against Ericsson, would have to be "shared" by Teltronics' bankruptcy trustee (35a), completely overlooks the fact that individual shareholder claims under Section 10(b) and Rule 10b-5 belong only to the shareholders, not to the bankruptcy estate. Such claims cannot be "shared" with Teltronics' trustee and therefore can have nothing to do with a "double recovery," the administration of the bankruptcy estate, or the priority of claims in a bankruptcy proceeding (35a). Teltronics' trustee only has standing to represent the interests of Teltronics. *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972) (trustee has no standing to maintain an action on the part of any person or entity other than his debtor corporation); *accord, Clarke v. Chase National Bank*, 137 F. 2d 797 (2d Cir. 1943). He clearly has no standing to assert a 10(b) claim on behalf of defrauded sellers of stock like the petitioners. *Rochelle v. Marine Midland Grace Trust Co.*, 535 F. 2d 523, 527 (9th Cir. 1976).

The effect of the Court of Appeals' ruling is to deny standing under the securities laws to the majority of Teltronics' shareholders who, while they were victimized by respondents' fraudulent manipulation of the national securities markets, were not swift enough, or astute enough, to sell their shares (at a loss) before the occurrence of Teltronics' bankruptcy. Hence, although those shareholders who sold their shares are plainly entitled to seek

recompense for Ericsson's fraudulent conduct, that fraud being "in connection with" the sale of their stock, those shareholders who, like petitioners, were equally damaged by the same fraudulent act, are by the Court of Appeals' ruling prohibited from also seeking compensation for their losses. Such a ruling plainly defeats the avowed purpose of Section 10(b) and Rule 10b-5, which, as stated in *Hooper v. Mountain States Securities Corp.*, 282 F. 2d 198, 202 (5th Cir. 1960), *cert. denied*, 35 U.S. 814 (1961), is designed "to keep the channels of interstate commerce, the mail, and national securities exchanges pure from fraudulent schemes, tricks, devices and all forms of manipulation," *See also, A.T. Brod & Co. v. Perlow*, 375 F. 2d 393, 397 (2d Cir. 1967) (Rule 10b-5 is designed to protect investors from deceptive schemes no matter how ingenious).

B. RICO Claim

In affirming the dismissal of petitioners' RICO claim, the Court of Appeals concludes, without support in the record, that petitioners' rights as shareholders are only "derivative" and can be asserted only through Teltronics. According to that Court, the injury sustained in the case was "to the firm" (38a), and petitioners' injury "only reflects the decrease in value of the firm" as a result of the alleged illegal conduct (38a). The Court of Appeals' statement is contrary to the facts in this case. The injury to petitioners was clearly *direct*, not derivative. Respondents' fraudulent press release was specifically "aimed at" Teltronics' shareholders in a successful attempt to dupe them into selling their stock. The damages sustained by each of the petitioners is plainly distinct and depends in each instance on such diverse factors as when each of the individual petitioners bought their stock and at what price, when they sold their stock and at what price, and whether, absent respondents' fraud on the market, each plaintiff might have been able to sell his or her shares at a higher price, *e.g.*, $9 a share, *etc.* As with petitioners' Section 10(b) claim,

petitioners' injury obviously cannot be redressed by Teltronics or its trustee. Petitioners are not suing for the "diminution" of the proportionate value of his or her interest in Teltronics, as the Court of Appeals suggests, but for harm sustained to the value of their stock by virtue of respondents' violation of a statutory duty that was owed *directly* to petitioners.

However, once having erroneously concluded that petitioners' injury is only "indirect" or "derivative," the Court of Appeals then simply applied the Sixth Circuit's interpretation of the RICO statute in the *Warren* case (decided prior to and without benefit of the Supreme Court's *Sedima* ruling) to the effect that a shareholder who is only "indirectly" or "derivatively" injured as a result of harm done to a corporation, has no standing to sue under RICO.

While it is true that a shareholder cannot maintain suit in his own name for injuries which only affect the corporation, *Stevens v. Lawder*, 643 F. 2d 1078 (5th Cir. 1981), a well-recognized exception to this general rule exists, as here, where the injury complained of creates not only a cause of action in favor of the corporation but also a cause of action in favor of a shareholder, as an individual, for violation of a duty owed directly to him. *Empire Life Insurance Co. v. Valdak Corp.*, 468 F. 2d 330, 335 (5th Cir. 1972); *Buschmann v. Professional Men's Association*, 405 F. 2d 659, 662 (7th Cir. 1969) ("It is well settled that an individual cause of action can be asserted when the wrong is both to the stockholder as an individual and to the corporation").

Finally, as previously noted, the decision of the *Warren* court was issued prior to this Court's *Sedima* decision. In *Sedima*, this Court considered and rejected the argument that a civil RICO plaintiff must allege some special type of injury incurred as a result of a RICO violation. Noting the statute's broad remedial

purposes, this Court found that *any* injury suffered as a result of a RICO defendant's conduct, whether direct or indirect, was compensable. This Court said:

> "(T)he plaintiff only has standing if, and can only recover to the extent that, he has been injured in his business or property by the conduct constituting the violation . . . . But the statute requires no more than this." *Id.*, 105 S. Ct. at 3285-3286.

Accordingly, petitioners have standing to sue under the RICO statute.

C. Antitrust Claim

The Court of Appeals does not mention this Court's decision in *Blue Shield of Virginia v. McCready*, 457 U.S. 465 (1982) in its explication of petitioners' alleged lack of standing under the federal antitrust laws. Instead, the Court of Appeals deems this Court's *Associated General* case as controlling, for the sole reason that this Court "noted favorably" the decision in *Loeb v. Eastman Kodak Co.*, 183 F. 2d 704 (3rd Cir. 1910) which held "as a matter of law" (37a), that neither a creditor nor a stockholder of a corporation can sue under the federal antitrust laws. The Court of Appeals fails to point out, however, that this Court's citation of the *Loeb* case was accompanied by clarifying language to the effect that the injuries sustained by plaintiff in *Loeb* were "derivative" and "indirect". *Associated General*, 459 U.S. at p. 534. This clarifying language squares with the Third Circuit's language in *Loeb* itself where the Third Circuit made it clear that plaintiff, unlike the petitioners in the instant case, was alleging no injury that was "direct" to himself ("[I]t is manifest that the plaintiff did not receive any direct injury from the alleged illegal acts of the defendant. . . . The injury complained of was directed at the corporation, and not the individual stockholder. Hence,

any injury which he, as a stockholder, received was indirect, remote and consequential"). *Loeb* at 709.

Had the plaintiff in *Loeb* pleaded direct injury to himself, as, for example, the intentional issuance of a false press release across the Dow Jones newswire to dupe plaintiff and his fellow shareholders into selling their stock, the result in the case would undoubtedly have been different. *See, e.g., Peter v. Western Newspaper Union*, 200 F. 2d 867, 872 (5th Cir. 1953) ("Under the general policy of the law applying in antitrust cases . . . a stockholder may maintain an action in his own right for an injury directly affecting him resulting from the violation of a duty owed the stockholder by a wrongdoer"). *Accord, Buschmann v. Professional Men's Association*, 405 F. 2d 659 (7th Cir. 1969); *Dann v. Studebaker-Packard Corp.*, 288 F. 2d 201 (6th Cir. 1961); *Costner v. Blount National Bank*, 578 F. 2d 1192, 1195 (6th Cir. 1978).

Clearly, then, under the allegations of the complaint, petitioners have standing to sue as *direct* victims of respondents' predatory activities since deceiving Teltronics' shareholders into selling their stock was both the "means" used and a "necessary step" in effectuating the ends of Ericsson's illegal bankruptcy conspiracy as well as being an "integral aspect of the conspiracy alleged." *McCready* at 479.

Ericsson and their attorneys obviously knew they were involved in a "tender offer" when they made a detailed written proposal to acquire a majority of Teltronics' stock—a proposal requiring majority shareholder approval—as well as when they set up a detailed agenda for compliance with federal law regarding such tender offers, including a proposed filing under Hart-Scott-Rodino, the submission of the requisite proxy materials to the SEC, and finally, a Schedule 13(d) filing under the Williams Act.

Ericsson's plan was for Teltronics to increase its authorized common stock to at least 3,000,000 shares and for Ericsson to purchase 750,000 shares of Teltronics' common stock for a consideration that would include both cash and the total assets of Ericsson's subsidiaries in Boston and Philadelphia (the financial condition of which could not have been known to Teltronics' shareholders without compliance with statutory disclosure requirements). In addition, Ericsson would have an option to purchase 30,000 additional Teltronics common shares and a right of refusal on another 288,644 shares. If the option and the right of first refusal were exercised, Ericsson would own a majority of Teltronics' outstanding stock.

In *Hanson Trust*, 774 F. 2d 47 (2nd Cir. 1985), the Second Circuit ruled that the "borderline" between public solicitations and privately negotiated stock purchases "is not bright, and it is frequently difficult to determine whether transactions falling close to the line or in a type of 'no-man's land' are 'tender offers' or private deals." *Id.* at 56. The Second Circuit therefore rejected rigid adherence to the SEC's recommended eight-factor test in favor of the principle followed by this Court in *Ralston Purina* in deciding what transactions fall within the private offering exemption provided by Section 4(1) of the Securities Act of 1933. According to *Hanson Trust*, since the purpose of the Williams Act is to protect the ill-informed solicitee, the question of whether a particular solicitation constitutes a "tender offer" turns on whether, viewing the transaction in the light of the "totality of circumstances," there is a substantial risk that, unless the Act is complied with, solicitees will "lack information" necessary to make "a carefully considered appraisal" of the tender offer proposal. *Id.* at 57.

The instant case was dismissed by the District Court prior to any answer having been filed and without any discovery being conducted. There was no effort made by the lower court to analyze

the facts of this case in terms of the "totality of circumstances" involved.[14] Similarly, the Court of Appeals' statements in its opinion that "the number of offerees was small" and that there was no "widespread" solicitation by Ericsson, is also made erroneously and without support of any kind in the record, and without consideration of the fact that Ericsson concededly intended to purchase a majority stock interest in Teltronics; and the fact that Ericsson's tender offer proposal required the approval of a majority of Teltronics' shareholder body to become effective. Neither the number nor the identity of the solicitees allegedly involved in the tender offer is anywhere set forth in the court of Appeals' opinion; nor is any reason given why that court believes the number of such solicitees is "small." The Court's further conclusion that these unidentified solicitees were "ideally positioned" to evaluate Ericsson's proposal is also unsupported by the record and entirely ignores Ericsson's fraudulent (and successful) attempt to deceive those same solicitees (and the other Teltronics' shareholders as well) by publishing a false press release across the Dow Jones broad tape.

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14. The District Court found—erroneously, and entirely contrary to the record—that (a) the number of "proposed sellers" in connection with Ericsson's tender offer consisted only of Teltronics' 3-man board of directors; that (b) these three individuals "should have known" about Teltronics' alleged financial condition; and (c) any "pressure" on these individuals to sell their stock was only an "indirect" effect of Ericsson's illegal activities against Teltronics.

CONCLUSION

For the foregoing reasons, a writ of certiorari should be granted and the judgment of the Court of Appeals should be reversed.

Respectfully submitted,

CARL E. PERSON
Counsel of Record
WALTER C. REID
Attorneys for Petitioners

APPENDIX A—MEMORANDUM AND ORDER OF JUDGE NEAHER DATED AND FILED AUGUST 30, 1985

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

83 CV 4268
(ERN)

MICHAEL M. RAND, JOHN COSTELLO, STEVEN J. COSTELLO, GREGORY T. FRESE, EDWARD LAVIN, PETER A. MILANO, and VINCENT F. SERVELLO,

Plaintiffs,

-against-

ANACONDA-ERICSSON, INC., ERICSSON, INC., L.M. ERICSSON TELEPHONE CO., NORDIC AMERICAN BANK, CITIBANK, N.A., PRICE-WATERHOUSE & CO., SULLIVAN & CROMWELL, RICHARD HOWE, RICHARD G. LYON, L. STANTON TOWNE, TELECOM EQUIPMENT CORP., and STEPHEN R. COHEN,

Defendants.

MEMORANDUM AND ORDER

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Appendix A

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Appendix A

Attorney for Defendants Telecom Equipment Corp. and Stephen R. Cohen

NEAHER, District Judge.

Plaintiffs are seven shareholders of the bankrupt Teltronics Services, Inc. They seek to represent a class of all such shareholders to redress various claims stemming from Teltronics' business relationships with defendant L.M. Ericsson Telephone Co. (Ericsson or Ericsson defendants).

The allegations of the present complaint are familiar to the Court. They involve the same series of events which furnished the basis for the litigation in *Teltronics Services, Inc. and Edward M. Beagan v. Anaconda-Ericsson, Inc., et al.*, 587 F. Supp. 724 (E.D.N.Y. 1984), *aff'd* 762 F.2d 185 (2d Cir. 1985), except that no claims are raised on behalf of Edward M. Beagan, Teltronics' founder, former president and substantial stockholder. In brief, plaintiffs claim that through a conspiracy originating with the Ericsson defendants, all of the defendants contributed to a plot to bankrupt Teltronics after the corporation would not succumb to takeover efforts.

According to the present complaint, from which the facts hereinafter related are derived, the friction between Teltronics and Ericsson, a Swedish based manufacturer of telephone equipment, began in 1978 when Teltronics, Ericsson's New York distributor of "interconnect" telephone equipment, opened an office to compete with Ericsson New England, a subsidiary Ericsson distributor. At about this time, one Gerald Tsai, a financier, sought to purchase 20% of Teltronics' stock and thereby represented a substantial source of alternative financing. Teltronics' then current method of financing equipment purchases

was through a security agreement in which Ericsson held a secured interest in the revenues generated by the leases of equipment to Teltronics' customers. Defendant Nordic American Bank (Nordic), which is an affiliate of Ericsson, and defendant Citibank supplied the money through notes, which contained an acceleration clause and the payment of which Ericsson guaranteed. The key component or aspect of the security agreement is illustrated in the allegations of ¶47 of the complaint, viz.,

> "47. Under the terms of the Loan Agreement, Teltronics was required to purchase a specific dollar amount of Ericsson's telephone equipment. If Teltronics failed to make purchases in the designated amount, Teltronics' loan repayment schedule under the Loan Agreement could be accelerated by Ericsson. Thus, in addition to assigning a security interest in its leases to Ericsson for the loan guarantees under the Loan Agreement, Teltronics was also required to buy telephone equipment from Ericsson in a dollar amount which far exceeded the amount of the loan which Ericsson guaranteed. For example, under the terms of the Loan Agreement with Nordic, Teltronics was required
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> > 'during the 12-month period commencing on the date of each Loan hereunder, Borrower (Teltronics) shall purchase from Guarantor (Ericsson USA) telephone switch equipment having an aggregate purchase price of not less than 175% of the amount of such Loan.' "

Plaintiffs add that this arrangement permitted Ericsson to

overcharge Teltronics for equipment that was not state of the art.

Concerned about Tsai's offer and the decrease in prices caused by Teltronics' competition in New England, Ericsson expressed interest in acquiring equity in Teltronics. In exchange for Teltronics' foregoing financing opportunities from Tsai, Ericsson agreed to provide debt financing for Teltronics' sales of Ericsson equipment. This offer was made only after Ericsson had insisted that Teltronics withdraw from New England, had refused to furnish vital "support" letters, by which Ericsson would have guaranteed service of the equipment, and had demanded that its loans to Teltronics not be used in the New England operation.

Apparently Ericsson's new business methods were having a sufficient effect that from December 1978 until February 1979 Teltronics and Ericsson discussed Ericsson's purchase of Teltronics stock. Teltronics, however, was opposed to Ericsson's acquiring a controlling interest.

In February 1979 the specter of a catastrophe loomed when Teltronics learned that the "ASB100" a machine intended to replace Ericsson's obsolete line of mechanical equipment, was a failure. As a result, Teltronics proposed a joint venture with Ericsson to develop a new product line, for which Ericsson would furnish a $25 million dollar loan. Alternatively, Teltronics would have to locate a new supplier to serve its substantial client base. Negotiations continued, and at this juncture plaintiffs reason that Ericsson, facing Teltronics' undesirable competition in New England and the possibility that Teltronics would engage a new supplier, thus cutting Ericsson out of the Northeastern United States market, had two choices: purchase Teltronics' shares at market prices or bankrupt the corporation through the security interest in the equipment leases. After choosing the latter option,

according to plaintiffs, Ericsson continued to negotiate, assertedly in bad faith, while it set in motion the events which would secure Teltronics' demise.

In January 1979, by letter to Nordic, Ericsson told the bank that if Teltronics did not make an interest payment of $230,000 due on February 28, 1979, the bank should charge Ericsson's account. During this same period, Ericsson assured Teltronics that as long as negotiations continued, financing would be forthcoming, so much so, that Ericsson agreed to a moratorium of principal and interest payments until March 31, 1979.

The due date of the interest payment also coincided with an exchange between defendant Price-Waterhouse & Co., Ericsson's accountants, and Blonder, Seymour and Shapss, Teltronics' accountants, who represented that they would give Teltronics an "unqualified" or "clean" opinion in the March 31, 1979 10-K filing with the Securities and Exchange Commission (SEC). As the complaint explains, this opinion placed an obstacle in Ericsson's way:

> "70. "* * * A 'clean' or 'unqualified' opinion would have resulted in at least a doubling of Teltronics' lines of credit. Indeed Sterling National Bank had already agreed to increase its loan commitment to Teltronics from $1,000,000 to $2,000,000. And it would also have ensured receipt by Teltronics of a $3,000,000 loan committed to Teltronics by Toshiba, a major Japanese trading company, in January 1979.
>
> "71. Price-Waterhouse asked Blonder, Seymour whether they were aware that certain

notes and interest payments were coming due for Teltronics, including the interest payment of $230,000 on the Nordic note which, Price-Waterhouse stated was due March 31, 1979. Blonder, Seymour told Price-Waterhouse that it still felt Teltronics would have no difficulty arranging adequate financing 'to meet commitments.'

"72. Price-Waterhouse by its telephone call was attempting to coerce Teltronics' accountants into withdrawing its unqualified opinion. If Price-Waterhouse had been successful in intimidating Teltronics' accountants into withdrawing their unqualified opinion, Teltronics' stock would have fallen (a result desired by Ericsson) and any increase in Teltronics' lines of credit would have evaporated."

In response, Ericsson allegedly hatched the fabrication of a non-existent bank default concerning the February 28, 1979 interest payment. This plan had been accelerated from March 31, 1979 in part to prevent Teltronics from publicly announcing that the ASB100 was an incurable failure, and thus an embarrassment to Ericsson's reputation in the industry. On February 28, 1979 defendant Richard Lyon, a member of the defendant law firm of Sullivan & Cromwell, told Nordic not to charge Ericsson's account because Ericsson wanted Teltronics to be in default. The grace period to make the interest payment extended to March 5, 1979, when an attorney for Ericsson telephoned Teltronics to inquire whether the interest payment had been made. Teltronics, of course, had not made the payment and only then realized that Ericsson's prior asaurances were no longer reliable.

Appendix A

Efforts to gather the necessary cash proved futile. Plaintiffs claim that because Teltronics had until March 31, 1979 to pay the interest, on the basis of Ericsson's representations, it could easily have sought assistance from other telephone equipment manufacturers that had already offered financing. This time period was unavailable because Nordic had declared a default according to plan. Ericsson paid Nordic $4,945,360.63. In response, Citibank accelerated its loans to Teltronics and on March 7, 1979 received a check from Ericsson for $3,008,632.10. The following press release, disseminated over the Dow Jones Wire Service, announced the event:

> "L.M. Ericsson Telecommunications says it filed Teltronics suit.
>
> 'NY-DJ-LM Ericsson Telecommunications, Inc. announced that it commenced an action against Teltronics Services, Inc. to recover $4.9 million which Ericsson as guarantor of Teltronics indebtedness had paid to Nordic American Bank, Inc.
>
> 'As part of that action, Ericsson had filed a motion seeking to attach certain Teltronics assets.
>
> 'That motion will be heard on March 9th in New York State Supreme Court in Queens County where the action was filed.
>
> 'On March 5th Ericsson said it declared Teltronics to be in default under a security agreement between them and today notified certain customers of Teltronics—whose leases are subject to the

security agreements—that payment should be made to Ericsson.

'1:43 p.m. E.S.T. March 6, 1979."

Complaint ¶111.

As a result of these events, Teltronics' stock plunged from $9 per share to $1 a share, causing the SEC to suspend its trading and leaving the corporation unable to find a source of financing. Customers cancelled $6 million in contracts, creditors demanded immediate payment of $2 million, accounts receivable not pledged to Ericsson refused to pay $3 million, and five banks offset $1 million in cash deposits. By September 1979 Ericsson had also persuaded creditors, of which it was the largest, to place Teltronics in involuntary bankruptcy.

Prior to that event, Ericsson had established its New York division on March 6, 1979, which recruited Teltronics' employees and solicited its former accounts. In June Ericsson interfered with Teltronics' attempt to salvage itself through a merger with Stromberg-Carlson, a division of General Dynamics. Teltronics also made a second attempt at revival in August through agreements with defendant Telecom Equipment Corp., of which defendant Cohen is chairman of the board. Teltronics assigned a long term office lease to Telecom in exchange for $50,000, $10,000 per month for 66 months, and a total of 3200 feet of space. Teltronics also became the exclusive sales representative for Telecom on a commission basis, servicing some 500 former accounts. On learning of this arrangement, Ericsson threatened to cut off Telecom's supply of parts needed to repair the equipment used by the aforementioned 500 accounts. Allegedly, Cohen joined the conspiracy when he acceded to Ericsson's demands, as

conveyed by the attorneys, and then evicted Teltronics from the building.

In sum, plaintiffs conclude that this was but one example of a pattern Ericsson followed to take over its subsidiary distributors for a modest amount. Allegedly, formerly independent businesses in Florida, Philadelphia, and Boston had been acquired in this manner.

Teltronics' litigation has been catalogued and summarized elsewhere. *Teltronics, supra*, 587 F. Supp. at 727-29; 762 F.2d at 187-88. On this motion for summary judgment, the Court will treat only the claims raised by plaintiffs.

At the outset, plaintiffs assert that defendants violated the Racketeer Influence and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1962(a), (b), (c), 1964(c). As predicate felonies to support a pattern of racketeering activity, they allege securities fraud, bankruptcy fraud, wire fraud, mail fraud, obstruction of justice, and obstruction of a criminal investigation by the SEC. Complaint ¶103.[1]

> "There can be little doubt that Fed.R.Civ.P. 9(b), which requires that allegations of fraud specify 'with particularity' the circumstances of the alleged fraud, applies to fraud allegations in civil RICO complaints."

Haroco v. American Nat. Bank, etc., 747 F.2d 384, 405 (7th Cir. 1984), *aff'd* 105 S.Ct. 329 (1985) (per curiam).

> "In order to allege mail fraud [or any other fraud], [plaintiffs] must state such matters as the time,

> place, and contents of the purported false representations. Additionally, [they] must 'specify in what respect each of the statements were false and misleading, and the factual basis for believing that the defendant acted with an intent to defraud'."

Doxie v. Ford Motor Credit Co., 603 F. Supp. 624, 627 (S.D. Ga. 1984) (citation omitted).

Concerning RICO, the complaint alleges,

> "99. Defendants, through the use of telephones, wire services and the mails, committed the fraud alleged in the complaint above and related activities of obtaining financial control over Teltronics, declaring a non-existent default, and employing false claims, defenses and testimony in the courts and bankruptcy proceedings against Teltronics and before the Securities and Exchange Commission during its investigation for the purpose of requiring Teltronics, against its will, to turn over its business assets and good will to Ericsson without Ericsson having to pay for Teltronics' stock or assets at their fair market or reasonable value.
>
> "100. Using the telephones, wire services and the mails, defendants (a) issued a fraudulent press release over the Dow Jones Wire Service; (b) solicited, encouraged and assisted some employees of Teltronics to file criminal charges against Teltronics' officers for alleged non-payment of

wages; (c) injured Teltronics' reputation with its customers; (d) acquired Teltronics' service contracts; (e) bribed Teltronics' personnel and removed its customer files; (f) prevented Teltronics from meeting its payroll; (g) closed down Teltronics' banking relationships; (h) acquired Teltronics' highly lucrative add-on business; (i) drove Teltronics into bankruptcy to be able to obtain the Teltronics' installed base or whatever was left through the bankruptcy court; (j) took over Teltronics' work in progress which at substantial expense to Teltronics had been substantially completed without corresponding payment to Teltronics and requested the Teltronics' customers to send the balance owed to defendant; and (k) made misrepresentations to Teltronics' customers saying that Teltronics could not service the account (which was false) and that Ericsson as the manufacturer could service the account, and through the making of such statements took over the servicing of the accounts."

Courts have recognized that

> "[t]o meet the Rule 9(b) standard a claimant must identify the circumstances constituting the fraud. This in turn involves identification of the particular defendant with whom the plaintiff dealt; designation of the occasions on which the fraudulent statements were made, and by whom; and designation of what misstatements or half-truths were made and how. (citations omitted). * * * As one court has recently pointed

> out, a '[p]laintiff is under a Rule 9(b) obligation when dealing with more than one defendant to specify which defendant told which lie under what circumstances.' *Mauriber v. Shearson/American Express, Inc.*, 546 F. Supp. 391, 394 (S.D.N.Y. 1983)."

Saine v. A.I.A., Inc., 582 F. Supp. 1299, 1303 (D.Colo. 1984).

In respect to the allegations of mail fraud and bankruptcy fraud, the deficiencies about which defendant did exactly what and when are apparent and totally lacking any alternative means of imparting precision or other measure of substantiation. *Compare Seville Industrial Machinery Corp. v. Southmost Machinery Corp.*, 742 F.2d 786, 791 (3d Cir. 1984), *cert. denied*, 105 S.Ct. 1179 (1985). The allegations of ¶100 of the complaint clearly add no specificity. *See Harris Trust, etc. v. Ellis*, 609 F. Supp. 1118, 1123 (N.D.Ill. 1985); *see also Hudson v. Larouche*, 579 F. Supp. 623, 629 (S.D.N.Y. 1983); *Friedlander v. Nims*, 571 F. Supp. 1188, 1194 (N.D.Ga. 1983), *aff'd on other grounds*, 755 F.2d 810, 813 n. 2 (11th Cir. 1985). In contrast, other portions of the complaint attribute the authorship of the allegedly deceptive and false press release to the firm of Sullivan & Cromwell.

The specificity requirement for pleading RICO predicate acts derives not only from Fed.R.Civ.P. 9(b) relating to allegations of fraud, but also from the definition of racketeering activity. Each act listed under 18 U.S.C. § 1961(1)(B) refers to a section of Title 18, which in turn contains the definition of a criminal offense.

> "Because a private damage action under RICO may be based on alleged criminal activity from ten

> years earlier, the factual basis of that activity must be pled with particularity. Otherwise the court is unable to determine whether the acts are 'indictable' and the defendant is unable to prepare its defense."

Bache, Halsey, etc. v. Tracy Collins Bank, 558 F. Supp. 1042, 1046 (D.Utah 1983). Nothing in ¶99 or anywhere else in the complaint alleges any acts which constitute the obstruction of justice referred to in 18 U.S.C. § 1503 or obstruction of a criminal investigation under 18 U.S.C. § 1510. Essentially, ¶99, similar to prior litigation, accuses the defendants of lying under oath to the bankruptcy court and to the SEC. Perjury, however, is not a RICO predicate act.

As explained below, the securities fraud claim offers no basis for a RICO predicate act; consequently, there being only one predicate act properly alleged, wire fraud, the RICO claim must be dismissed. *See Moss v. Morgan Stanley, Inc.*, 719 F.2d 5, 19 (2d Cir. 1983), *cert. denied sub nom. Moss v. Newman*, 104 S.Ct. 1280 (1984).

The complaint also suffers from an additional flaw. All of defendants' alleged acts were directed at Teltronics; consequently, plaintiffs are shareholders suing to redress injuries inflicted upon their corporation. Drawing an analogy to the antitrust laws, the court in *Warren v. Manufacturers Nat. Bank, etc.*, 759 F.2d 542 (6th Cir. 1985), ruled, in the context of RICO, that "diminution in value of the corporate assets [what plaintiffs allege occurred here] is insufficient direct harm to give the shareholder standing to sue in his own right." *Id.* at 544 (citations omitted). In so ruling, the court observed that this aspect of standing to pursue a RICO claim is unrelated to the type of injury required to support a RICO

claim. *Id.* at 545. While the court did not have the benefit of the decision in *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 105 S.Ct. 3275 (1985), nothing in the Court's interpretation of the RICO statute there addresses the issue at bar. As the court in *Warren* also noted,

> "Whether RICO should or should not be interpreted to 'federalize' common law fraud is an issue distinct from whether it should be interpreted to materially expand the standing requirement applicable to such claims. Allowing every shareholder, employee and creditor a cause of action for injuries derivative of those suffered directly by a corporation does not just permit a vast amount of litigation to be brought in federal court that previously could only have been brought in state court, but creates a potential avalanche of suits that previously could not have been brought *at all*."

759 F.2d at 545 (original emphasis).

Here, Teltronics' bankruptcy trustee litigated, lost, and then settled the corporation's claims against the Ericsson defendants and is pursuing to settlement claims against Telecom. Defendants' alleged activities in furtherance of the asserted conspiracy were directed at Teltronics; consequently, as shareholders, plaintiffs' rights, if any, are only derivative. Were it not for a broad interpretation of 18 U.S.C. § 1964, which this Court declines to adopt because such interpretation would ignore the traditional principle of corporation law that shareholders may not sue for claims their insolvent corporation has settled, most of the instant suit could not have been brought at all.[2]

Appendix A

The state and federal securities claims urged by plaintiffs are identical to the claims Edward Beagan raised in prior litigation. *Teltronics Services, Inc., supra*, 587 F. Supp. at 731-32. Plaintiffs have presented nothing which compels or merits a different result. Accordingly, the Court incorporates its earlier discussion of these claims by reference. *Id.*

Contrary to defendants' argument, and in support of its earlier statement that "in certain circumstances, a bankruptcy liquidation may constitute a sale for purposes of § 10(b) and Rule 10b-5 of the Securities Exchange Act of 1984," 587 F. Supp. at 731, the Court refers defendants to *Alpex Computer Corp. v. Pitney-Bowes, Inc.*, 417 F. Supp. 328, 330-32 (S.D.N.Y. 1976) (cases cited and discussed therein). The concept of the "forced seller", which furnishes the basis for the securities claims, is applicable only when a stockholder has been forced by fraudulent means into a situation offering no alternative but to dispose of his stock for cash. *Mayer v. Oil Field Systems Corp.*, 721 F.2d 59, 65 (2d Cir. 1983). Since a bankruptcy liquidation often results in no cash for the shareholders, it is unlike other "forced seller" situations. *See Landy v. F.D.I.C.*, 486 F.2d 139, 159 (3d Cir. 1973), *cert. denied*, 416 U.S. 960 (1974) (discussion therein). But whatever the merit in plaintiffs' argument that they may proceed despite the absence of a sale of their shares, subsequent case law supports the Court's earlier decision concerning the lack of proximate causation between plaintiffs' allegedly "forced sale" and the defendants' alleged misrepresentations. *Bennett v. United States Trust Co.*, ____ F.2d ____, ____ (2d Cir. August 9, 1985); *Bloor v. Carro, Spanbock, etc.*, 754 F.2d 57, 61 (2d Cir. 1985).[3]

The parties have submitted lengthy affidavits concerning the oral argument of Beagan's appeal (762 F.2d 185) accompanied by a promise to furnish the transcript. Plaintiffs contend and

defendants dispute that the panel, and especially Judge Timbers, expressed disagreement with this Court's rulings on plaintiffs' securities claims in the context of the Beagan case. Assuming *arguendo* that this Court's view of plaintiffs' securities claims is erroneous, neither their remedy nor their strategy for successful persuasion lie in the citation of remarks made by appellate judges during the give and take of oral argument.

Plaintiffs also assert a claim pursuant to 15 U.S.C. § 78n(e) (§ 14(e) of the Williams Act), which concerns tender offers. In their memorandum of law at 19 they state,

> "The complaint delineates the making of a tender offer for Teltronics' shares by (a) the Tsai interests; (b) the Loral Corporation; (c) Ericsson's formal tender offer prepared by Sullivan & Cromwell; and (d) Ericsson's and Sullivan & Cromwell's widespread solicitation of Teltronics' shareholders after issuance of the Dow Jones press releases by Ericsson, Sullivan & Cromwell and Kleban. Defendants' manipulative and fraudulent conduct was in connection with all of these tender offers."

Kleban was an employee of Teltronics, allegedly fired for issuing an unauthorized press release on March 5, 1979, which confirmed that Teltronics was in default on the interest payment. Whatever the significance of this second press release, the plaintiffs' basis for the § 14(e) claim and, as best as the Court can discern, all of their securities fraud claims, see plaintiffs' memorandum of law at 24-26, is Ericsson's press release. Assertedly, it failed to disclose material facts and constituted a successful manipulative device, because it artificially affected the market in Teltronics'

stock and thereby misled investors. See plaintiffs' memorandum of law at 20. The complaint does not allege the existence of any tender offer or actions suggesting a tender offer at the time of the press release, *see S.E.C. v. Carter Hawley Hale Stores, Inc.*, 760 F.2d 945, 950 (9th Cir. 1985); therefore, plaintiffs fail to meet the "in connection with any tender offer, etc.," requirement of § 14(e).

Plaintiffs' antitrust claim pursuant to § 1 of the Sherman Act must suffer the same fate as Beagan's similar claim in the prior litigation. The Court incorporates herein its earlier discussion of this matter by reference to 587 F. Supp. at 729-30. In brief, as stockholders, plaintiffs have not established their standing to sue for antitrust claims arising from injuries to Teltronics.

For the foregoing reasons, defendants' motion for summary judgment is granted in its entirety, and the complaint is dismissed. As a result, the Court need not consider plaintiffs' motion to disqualify the firm of Sullivan & Cromwell and its members named as defendants. The Court, however, must consider defendants' request for costs, attorneys fees, and an injunction barring plaintiffs and their counsel from commencing any additional litigation based upon matters alleged in the complaint.

As to the need for an injunction, the same attorneys, who represented Beagan in the prior action brought on his behalf, represent the instant plaintiffs. Despite this Court's injunction, which prohibited Beagan from further litigating claims belonging to Teltronics, these attorneys filed an appeal on Teltronics' behalf without first seeking a stay of that order from this Court. The appeal resulted in the affirmance of this Court's dismissal of Beagan's complaint, including the entering of the injunction, and the affirmance of the Bankruptcy Court's approval of the

settlement of Teltronics' claims, which includes the antitrust claim alleged in the complaint. Despite the fact that Beagan was not permitted to litigate claims belonging to Teltronics, plaintiffs' attorneys' continued attempts to relitigate those claims by substituting other Teltronics shareholders must be deemed a flagrant attempt to circumvent the order of the Court of Appeals and the prior rulings of this Court.

At least as to claims not belonging to Teltronics, *i.e.*, securities fraud, plaintiffs' attorneys were obligated to submit authority which showed that the Court had erred in addressing these same claims as raised by Beagan. Instead, this Court has found that recent cases, not cited by plaintiffs, render their securities fraud contentions more dubious than when they were asserted on behalf of Beagan and rejected. *See National Survival Game v. Skirmish U.S.A., Inc.*, 603 F. Supp. 339, 341-42 (S.D.N.Y. 1985).

In short, plaintiffs' attorneys have sought to rehash what has been reviewed twice in the Southern District of New York, twice in the Bankruptcy Court in the Eastern District of New York (the second time resulting in a settlement by the Trustee), and now twice in the Eastern District of New York. In so doing, they have also filed many irrelevant documents related to matters concluded in other courts. *See Limerick v. Greenwald*, 749 F.2d 97, 101 (1st Cir. 1984). Given those circumstances, and the fact that this Court's prior decision, 587 F. Supp. 724, and its opinion on reargument should have communicated the frivolity of that suit to any reasonable attorney, plaintiffs' attorneys' opposition to the instant motion for summary judgment, premised upon nothing new, cannot be sanctioned.

As pointed out in *Tedeschi v. Smith Barney, etc.*, 579 F. Supp. 657, 661 (S.D.N.Y. 1984), *aff'd* 757 F.2d 465 (2d Cir. 1985)

(per curiam) (citations omitted; emphasis added):

> "An essential requirement underlying fee shifting, contrary to the general American Rule, is a finding of bad faith on the part of the unsuccessful litigant. An action is brought in bad faith when the claim is entirely without color and has been asserted wantonly, for the purpose of harassment or delay, or for other improper reasons. The bad faith exception justifying an award of counsel fees and other expenses of litigation extends both to the filing and *the prosecution of the litigation*. The sanction is imposed under the court's inherent equitable power when the interests of justice so require.
>
> "The assessment of fees for bad faith conduct, when exercised under the court's equitable power, may be imposed upon the errant litigant and his lawyer."

A clear showing of bad faith has been made here. Given the punitive nature of the Court's power to charge an attorney, who acts in bad faith, with costs and fees, the punishment should be limited to the excess costs, expenses, and fees of the prevailing party. *See Knorr Brake Corp. v. Harbil, Inc.*, 738 F.2d 223, 226 (7th Cir. 1984). Cognizant of this standard, the Court finds that its opinion and the Court of Appeals' opinion in the Beagan lawsuit, along with all the other related litigation concerning Teltronics, should have convinced plaintiffs' attorneys of the lack of merit in the instant suit and persuaded them not to oppose the instant motion for summary judgment.

Appendix A

Accordingly, defendants' request for reimbursement for their reasonable attorneys fees and expenses, to be paid by plaintiffs' attorneys, is granted for all such fees and expenses incurred after March 22, 1985, the date the Court of Appeals issued its decision. Additionally, plaintiffs and their attorneys are enjoined from pursuing any new or pending litigation which concerns Teltronics Services, Inc.

SO ORDERED.

Copies of this Memorandum and Order are being forwarded to counsel for the parties.

s/ Edward R. Neaher
U.S.D.J.

Dated: Brooklyn, New York
August 30, 1985

Appendix A

FOOTNOTES

1. Paragraph 96 also refers to the collection of unlawful debts; however, there is no allegation that meets the definition of an "unlawful debt" under 18 U.S.C. § 1961(6).

2. Given the inadequacy of the RICO allegations, the Court need not consider whether this RICO action is time barred by the three year statute of limitations of N.Y.C.P.L.R. § 214 subd. 3. *See Durante Bros., etc. v. Flushing Nat. Bank*, 755 F.2d 239, 248-49 (2d Cir.), *cert. denied*, 105 S.Ct. 3530 (1985).

3. In this context the holding of *In Re Investors Funding Corp., etc.*, 523 F. Supp. 533, 544 (S.D.N.Y. 1980), upon which this Court relied to dismiss Beagan's claim pursuant to N.Y.Gen.Bus.Law § 352-c (blue sky statute), has been implicitly approved. *See Bloor, supra*, 754 F.2d at 60 n. 2.

APPENDIX B—JUDGMENT DATED JANUARY 30, 1986 FILED JANUARY 31, 1986 DISMISSING THE PETITIONERS' COMPLAINT

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF NEW YORK

CV 83 4268 (ERN)

MICHAEL M. RAND

Plaintiffs,

-against-

ANACONDA-ERICSSON, INC.

Defendants.

JUDGMENT

A order of Honorable Edward R. Neaher, United States District Judge, having been filed on August 30, 1985, dismissing the plaintiff's complaint, it is

ORDERED and ADJUDGED that the plaintiff's complaint is dismissed.

/s Robert C. Heinemann
ROBERT C. HEINEMANN
Clerk of Court

Dated: Brooklyn, New York
January 30, 1986

APPENDIX C—DECISION OF THE SECOND CIRCUIT DECIDED JULY 9, 1986

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 978—August Term, 1985

(Argued March 31, 1986 Decided July 9, 1986)

Docket No. 86-7034

MICHAEL M. RAND, JOHN COSTELLO, STEVEN J. COSTELLO, GREGORY T. FRESE, EDWARD LAVIN, PETER A. MILANO and VINCENT F. SERVELLO,

Plaintiffs-Appellants,

—v.—

ANACONDA-ERICSSON, INC., ERICSSON, INC., L.M. ERICSSON TELEPHONE COMPANY, NORDIC AMERICAN BANK, CITIBANK, N.A., PRICE-WATERHOUSE & CO., SULLIVAN & CROMWELL, RICHARD HOWE, RICHARD G. LYON, L. STANTON TOWNE, TELECOM EQUIPMENT CORP. and STEPHEN R. COHEN,

Defendants-Appellees.

Appendix C

Before:

OAKES, NEWMAN and WINTER,
Circuit Judges.

Appeal from a grant of summary judgment by the United States District Court for the Eastern District of New York (Edward R. Neaher, *Judge*), dismissing the complaint of shareholders of a bankrupt corporation who claim damage under the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.*, Section 1 of the Sherman Act, 15 U.S.C. § 1, Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e), and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985).

Affirmed.

WALTER C. REID, New York, New York (Carl E. Person, New York, New York, of counsel), *for Plaintiffs-Appellants.*

ROBINSON B. LACY, New York, New York (Robert M. Osgood, Sullivan & Cromwell, New York, New York, of counsel), *for Defendants-Appellees Anaconda-Ericsson, Inc., Ericsson, Inc., L M Ericsson Telephone Co., Sullivan & Cromwell, Richard R. Howe, Richard G. Lyon, and L. Stanton Towne.*

Appendix C

Richard G. Lyon, Greenwich, Connecticut, *pro se* and *for Defendants-Appellees Anaconda-Ericsson, Inc., Ericsson, Inc., and L M Ericsson Telephone Co.*

Allan L. Gropper and Robert J. Morrow, White & Case, New York, New York, *for Defendant-Appellee Nordic American Banking Corp.*

Philip K. Howard, Howard, Darby & Levin, New York, New York, *for Defendant-Appellee Price Waterhouse & Co.*

William B. Pennell, Shearman & Sterling, New York, New York, *for Defendant-Appellee Citibank, N.A.*

Paul S. McDonough, Long Island City, New York, *for Defendants-Appellees Telecom Equipment Corp. and Stephen R. Cohen.*

WINTER, *Circuit Judge*:

This case arises out of the relationship between Teltronics Services, Inc. ("Teltronics"), a now-bankrupt distributor of telephone equipment, and its principal creditor and supplier, L.M. Ericsson Telecommunications, Inc. ("Ericsson"). This action was brought by a number of Teltronics shareholders who allege that the company's collapse was caused by actions of the several defendants. These defendants include companies affiliated with Ericsson as well as other parties that are alleged to have aided Ericsson in its plan to force Teltronics into

bankruptcy. The shareholders seek damages under a number of statutes: the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. § 1961 *et seq.* (1982); Section 1 of the Sherman Act, 15 U.S.C. § 1 (1982); Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e) (1982); and Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985). Judge Neaher granted summary judgment for defendants. *Rand v. Anaconda-Ericsson, Inc.*, 623 F. Supp. 176 (E.D.N.Y. 1985). We affirm.

BACKGROUND

This action is only the latest in a series of cases arising out of the commercial demise of Teltronics. *See Teltronics Services, Inc. v. Anaconda-Ericsson, Inc.*, 587 F. Supp. 724 (E.D.N.Y. 1984), *aff'd*, 762 F.2d 185 (2d Cir. 1985); *L M Ericsson Telecommunications, Inc. v. Teltronics Services, Inc.* (*In re Teltronics Services, Inc.*), 18 Bankr. 705 (E.D.N.Y. 1982); *Teltronics Services, Inc. v. L M Ericsson Telecommunications, Inc.*, 486 F. Supp. 836 (S.D.N.Y.), *on reargument*, 491 F. Supp. 538 (S.D.N.Y. 1980), *aff'd*, 642 F.2d 31 (2d Cir.), *cert. denied*, 452 U.S. 960 (1981); *Teltronics Services, Inc. v. L.M. Ericsson Telephone Co.*, No. 79 Civ. 1233, slip op. (S.D.N.Y. May 9, 1979).

According to the complaint, Ericsson was the chief supplier of telephone equipment to Teltronics and also its principal creditor. Friction between the two companies began in 1978, when the New York-based Teltronics opened an office to compete with an Ericsson subsidiary in New England. Teltronics' method of financing equipment purchases was through the issuance of notes to

defendants Citibank, N.A. ("Citibank") and Nordic American Bank ("Nordic"), an Ericsson affiliate. Payment on these notes was guaranteed by Ericsson. In return for the guarantee, Ericsson held a security interest in the revenues generated by Teletronics' leases of equipment. The loan agreements contained an acceleration clause, under which the lenders could demand the outstanding balance on the notes in the event that Teltronics was late in making a monthly interest payment.

Plaintiffs' theory is that Ericsson led Teltronics to believe that it need not make an interest payment due to Nordic at the end of February, 1979. When Teltronics failed to make the payment, a default and acceleration was declared by Nordic, and Ericsson, as guarantor of the notes, paid the loans. Teltronics, unable to find alternative sources of financing, was forced into involuntary bankruptcy in September, 1979. The default and subsequent bankruptcy allegedly allowed Ericsson to receive the income from many of Teltronics' equipment leases under its security interest, and also to set up a New York subsidiary that eventually took a great many of Teltronics' customers for itself.

Meanwhile, litigation began. A first action, filed by Teltronics in the United States District Court for the Southern District of New York, alleged that the default was engineered by Ericsson in order to take over Teltronics' business. The complaint was dismissed under Fed. R. Civ. P. 12(b)(6), *Teltronics Services, Inc. v. L.M. Ericsson Telephone Co.*, No. 79 Civ. 1233, slip op. (S.D.N.Y. May 9, 1979), and no appeal was taken. Teltronics filed a second action in the Southern District three months after judgment was entered, based on the same course of conduct alleged in the first. The District

Court for the Southern District dismissed Teltronics' second action on res judicata grounds. This court affirmed. *Teltronics Services, Inc. v. L M Ericsson Telecommunications, Inc.*, 486 F. Supp. 836 (S.D.N.Y.), *on reargument*, 491 F. Supp. 538 (S.D.N.Y. 1980), *aff'd*, 642 F.2d 31 (2d Cir.), *cert. denied*, 452 U.S. 960 (1981).

Meanwhile, on September 18, 1979, while the second action in the Southern District was pending, creditors initiated an involuntary bankruptcy proceeding against Teltronics in the Eastern District. On April 30, 1980, Teletronics was adjudicated a bankrupt. A trustee in bankruptcy was appointed and sought to assert a claim for equitable subordination of Ericsson's claims against the bankrupt. After a twenty-day trial, Bankruptcy Judge Parente held in a detailed opinion that Ericsson had not engaged in misconduct and that equitable subordination was not warranted. In particular, he found that Ericsson "never represented to Teltronics that Teltronics would not be required to make a timely payment of the interest due to Nordic on February 18, 1979," and that the Teltronics management knew that the company was obliged to pay the interest to Nordic on that date. *Anaconda-Ericsson, Inc. v. Hessen (In re Teltronics Services, Inc.)*, 29 Bankr. 139, 157 (E.D.N.Y. 1983). The trustee appealed, but a settlement was reached between the trustee and Ericsson before the appeal was argued. Other Teltronics creditors, including Rand and Frese, shareholder plaintiffs in the present action, challenged the settlement, which was nevertheless upheld by the bankruptcy court, the district court, and ultimately this court. *See In re Teltronics Services, Inc.*, 762 F.2d at 188.

Meanwhile, on April 12, 1983, Edward Beagan, Chairman of Teltronics' Board, brought an action on behalf of

himself and Teltronics against Ericsson in the Eastern District on grounds similar to those pressed in the instant case. Judge Neaher held that only the bankruptcy trustee could represent Teltronics and granted summary judgment against Beagan on his individual claims. *Teltronics Services, Inc. v. Anaconda-Ericsson, Inc.*, 587 F. Supp. 724, 729, 734. Beagan's case was consolidated on appeal with the challenge to the settlement and was also affirmed. *In re Teltronics Services, Inc.*, 762 F.2d at 193.

The current action was filed in the Eastern District on September 23, 1983, by seven named plaintiffs who sought to represent a class of all those who on or after March 5, 1979, were shareholders of Teltronics. Although the present case involves new plaintiffs, the underlying events are exactly the same as those that spawned the earlier litigation. Plaintiffs' factual claims, moreover, were rejected by the bankruptcy court after a twenty-day trial. That court found that Ericsson and its agents never represented to Teltronics that Teltronics would not be required to make a timely payment of the interest due to Nordic on February 28, 1979, and that the Teltronics management knew that the company was obliged to pay the interest to Nordic on that date. *Anaconda-Ericsson, Inc. v. Hessen (In re Teltronics Services, Inc.)*, 29 Bankr. at 157.

Defendants moved in November, 1983, to dismiss and for summary judgment. Before plaintiffs filed opposing papers, a conference was held at which the district court advised the parties that it was holding defendants' motion in abeyance pending the outcome of the appeal concerning the trustee's settlement and the Beagan action, eventually decided on March 22, 1985. *In re Teltronics Services, Inc.*, 762 F.2d 185. On August 30, 1985, Judge

Appendix C

Neaher granted defendants' motion for summary judgment in its entirety and dismissed the complaint. *Rand v. Anaconda-Ericsson, Inc.*, 623 F. Supp. 176, 184 (E.D. N.Y. 1985). Plaintiffs and their attorneys were enjoined from pursuing any new or pending litigation that concerns Teltronics. *Id.* at 185. The district court also held that sanctions under Rule 11, Fed. R. Civ. P., were appropriate, but did not determine the actual amount to be paid. After the district judge denied plaintiffs' motion to reconsider, this appeal followed.

DISCUSSION

1. *The Securities Exchange Act Claim*

Plaintiffs allege that Ericsson issued a fraudulent press release over the Dow Jones newswire on March 6, 1979, and that this fraud was "in connection with the purchase or sale of a security" in violation of Section 10(b) and Rule 10b-5.[1]

The press release, which is set out in the margin,[2] announced that Ericsson had declared Teltronics to be in

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1 The relevant text of Section 10(b), 15 U.S.C. § 78j(b), provides:

> It shall be unlawful for any person, . . .
>
> . . .
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe . . . .

Rule 10b-5 also is limited to fraudulent behavior "in connection with the purchase or sale of any security." 17 C.F.R. § 240.10b-5 (1985).

2 As alleged in the complaint, the press release issued over the Dow Jones newswire on March 6, 1979, stated in full:

> L. M. Ericsson Telecommunications says it filed Teltronics suit.

(footnote continued on following page)

default under its security agreement and that it was commencing legal action against Teltronics to recover the payments Ericsson had made as guarantor. Plaintiffs allege that Ericsson's accountants, Price-Waterhouse & Co., had advised Teltronics' accountants that no payment of interest or principal on any of the Nordic or Citibank loans was due until March 31, 1979. They further allege that Ericsson's attorneys, Sullivan & Cromwell, secretly met with the president of the Nordic bank and told him not to credit Teltronics' account with $250,000 then on deposit at the bank because Ericsson wanted a "nominal" default on the interest payment.

Plaintiffs also allege that at all pertinent times Teltronics had various corporate suitors attempting to acquire it. They claim that the press release was part of a scheme to prevent Teltronics from being acquired, and thus to assure that Ericsson could take over Teltronics' business. Plaintiffs reason that the press release discouraged the corporate suitors, made it impossible to secure other sources of financing, and directly resulted in Teltronics' involuntary bankruptcy. Once in bankruptcy,

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(Footnote continued from previous page)

> NY—DJ—LM Ericsson Telecommunications, Inc. announced that it commenced an action against Teltronics Services, Inc. to recover $4.9 million which Ericsson as guarantor of Teltronics indebtedness had paid to Nordic American Bank, Inc.
>
> As part of that action, Ericsson had filed a motion seeking to attach certain Teltronics assets.
>
> That motion will be heard on March 9th in New York State Supreme Court in Queens County where the action was filed.
>
> On March 5th Ericsson said it declared Teltronics to be in default under a security agreement between them and today notified certain customers of Teltronics—whose leases are subject to the security agreements—that payment should be made to Ericsson.
>
> 1:43 p.m. E.S.T. March 6, 1979.

plaintiffs' shares were converted into a claim for cash, a situation which plaintiffs argue constitutes a "forced sale." Plaintiffs conclude that this "forced sale" renders the press release a misrepresentation made "in connection with" a securities transaction for purposes of Section 10(b).

We disagree. To fall within Section 10(b), misrepresentations must have some direct pertinence to a securities transaction. In *Chemical Bank v. Arthur Anderson & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 105 S. Ct. 253 (1984), for example, an auditor misrepresented the financial condition of a corporation seeking a loan from the bank. The loan was to be collateralized by the stock of the borrower's subsidiary. We noted that none of the alleged misrepresentations pertained to the pledged securities and that the incidental involvement of securities as collateral did not by itself implicate the anti-fraud provisions of the federal securities laws. In *Securities and Exchange Commission v. Drysdale Securities Corp.*, 785 F.2d 38 (2d Cir. 1986), *cert. denied*, 54 U.S.L.W. 3809 (U.S. June 9, 1986) (No. 85-1744), however, we held that misrepresentations about the financial condition of a broker-dealer were "in connection with" a securities transaction where the broker-dealer's financial strength was directly related to its ability to carry out obligations under agreements calling for the repurchase or resale of government securities. The misrepresentations thus went to the consideration for a securities transaction. In the present case we do not have even the incidental involvement of securities that existed in *Chemical Bank*. Only the filing for bankruptcy in September, 1979, viewed in the most tortured fashion, purports to link the conduct of the defendants to the purchase or sale of a security.

Appendix C

The "forced sale" doctrine is of no aid to appellants, however, because its application has been limited to securities transactions resulting in an intra-firm freeze-out of one group of investors by another. *Mayer v. Oil Field Systems Corp.*, 721 F.2d 59 (2d Cir. 1983) (buyout of limited partners with artificially overvalued stock); *Coffee v. Pernion Corp.*, 434 F.2d 383 (5th Cir. 1970) (fraud on minority shareholders in a liquidation), *cert. denied*, 412 U.S. 920 (1973); *Vine v. Beneficial Finance Co.*, 374 F.2d 627 (2d Cir.) (fraud in scheme involving purchase of one class of securities, followed by tender offer for another class, followed by short-form merger), *cert. denied*, 389 U.S. 970 (1967). These cases involve conventional transactions in the capital market where the transaction allegedly involves fraud, and some securities holders are forced by other investors in the same firm to trade their investments for cash.

Plaintiffs' claim is based upon a virtually limitless legal theory that would convert any fraudulent conduct resulting in a corporate bankruptcy into securities fraud. For instance, it would encompass misrepresentations about the nature of a competitor's goods or the use of industrial spies, conduct wholly remote from transactions in the market for capital. The artificiality of the theory is further demonstrated by the fact that the securities laws would come into play only when a bankruptcy occurs. Shareholders injured by the very same conduct but whose company was merely diminished in value rather than destroyed would have no right of action.

The perversity of appellants' argument is further demonstrated by consideration of the effect it would have, if adopted, on bankruptcy proceedings. The damage claim asserted by the shareholders is identical to Teltronics'

claim against Ericsson for tortious interference with its business. If Teltronics' bankruptcy were to trigger an otherwise non-existent Section 10(b) claim, the bankruptcy court would not be able to accord the various claimants their proper priority in the distribution of assets. A major corporate asset, the claim against Ericsson, would by virtue of the bankruptcy itself be shared by the bankruptcy trustee and the shareholders as well. Were we to recognize the shareholders' claim as valid, many undesirable results would follow. First, the actual value of the bankrupt estate could not be determined. Second, either the defendants would be forced to pay a double recovery or the rights of senior claimants, the creditors, would be subordinated to the rights of the most junior claimants, the equity holders. In the present case, Ericsson settled with the trustee in the understandable belief that he alone could assert the damage claim. Had there been any hint that individual shareholders could also assert this claim, a settlement would have been possible only if the shareholders were also satisfied, a condition that would have made the terms available to creditors less favorable.

2. *The Williams Act Claim*

Plaintiffs claim that a December 5, 1978 letter from Ericsson to Beagan constitutes a "tender offer," and that the Ericsson press release announcing the Teltronics default was thus a false or misleading communication "in connection with" this tender offer prohibited by Section 14(e) of the Williams Act, 15 U.S.C. § 78n(e).

The letter to Beagan proposed a transaction in which Ericsson would purchase 785,000 Teltronics shares and an option for an additional 330,000 shares from Teltronics.

Ericsson would also have gained a right of first refusal to purchase 288,644 shares from Beagan. The transaction was conditioned upon further investigation, including an audit, of Teltronics by Ericsson; approval by Ericsson's board of directors; and approval by Teltronics' stockholders following the distribution of proxy materials.

The present case is directly controlled by *Hanson Trust PLC v. SCM Corp.*, 774 F.2d 47 (2d Cir. 1985). We held there that several private purchases of securities did not constitute a tender offer under the Williams Act. We noted generally that

> the question of whether a solicitation constitutes a "tender offer" within the meaning of § 14(d) turns on whether, viewing the transaction in light of the totality of circumstances, there appears to be a likelihood that unless the pre-acquisition filing strictures of that statute are followed there will be a substantial risk that solicitees will lack information needed to make a carefully considered appraisal of the proposal put before them.

Id. at 57. As in *Hanson Trust*, the number of offerees in the present case was small, there was no widespread solicitation, the putative sellers were ideally positioned to appraise the offer, there was no pressure in light of the tentative and conditional nature of the letter, and there was no time limit. *Id.* at 57-58. The letter, therefore, lacked the essential characteristics of a tender offer, and misstatements, if any, in the Ericsson press release cannot support a claim under the Williams Act.

3. *The Sherman Act Claim*

The district court correctly held that plaintiffs' claim under Section 1 of the Sherman Act, 15 U.S.C. § 1, failed for lack of standing. 623 F. Supp. at 184; *see also* 587 F. Supp. at 730. In *Associated General Contractors of California, Inc. v. California Council of Carpenters*, 459 U.S. 519 (1983), the Supreme Court noted favorably the decision in *Loeb v. Eastman Kodak Co.*, 183 F. 704 (3d Cir. 1910), stating that *Loeb* "held as a matter of law that neither a creditor nor a stockholder of a corporation that was injured by a violation of the antitrust laws could recover." *Associated General*, 459 U.S. at 533. In *Loeb*, as in the instant case, a stockholder/creditor sued under the antitrust laws, alleging that his stock was rendered worthless and that his claim against the company was only partially satisfied because defendants' alleged antitrust violation drove the company into bankruptcy. *See* 183 F. at 706-07. The court held that only the bankruptcy trustee could assert the claims set forth in the complaint, and, therefore, that the plaintiff lacked standing. Plaintiffs' antitrust claim is without merit.

4. *The RICO Claim*

Plaintiffs assert that defendants violated the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1962(a),(b),(c), 1964(c) (1982). As predicate felonies to support a pattern of racketeering activity, they allege securities fraud, bankruptcy fraud, wire fraud, mail fraud, obstruction of justice, and obstruction of a criminal investigation by the Securities and Exchange Commission. 623 F. Supp. at 180. The district court dismissed the RICO claim on two grounds. First, it held that the complaint properly alleged only one predicate

act—wire fraud arising from the Ericsson press release—and therefore did not meet the RICO requirement of two predicate acts. 623 F. Supp. at 182. As a second basis for dismissal, the district court held that plaintiffs' rights are merely derivative of those of Teltronics, and that plaintiffs therefore lack standing to sue under RICO. *Id.*

We agree with the district court that plantiffs lack standing to sue under RICO, for reasons similar to their lack of standing under the antitrust laws. The legal injury, if any, was to the firm. Any decrease in value of plaintiffs' shares merely reflects the decrease in value of the firm as a result of the alleged illegal conduct. The Sixth Circuit has dismissed a RICO claim in exactly this setting, saying that under RICO an

> "action to redress injuries to a corporation cannot be maintained by a shareholder in his own name but must be brought in the name of the corporation. The shareholder's rights are merely derivative and can be asserted only through the corporation. . . . [D]imunition in value of the corporate assets is insufficient direct harm to give the shareholder standing to sue in his own right."

Warren v. Manufacturers National Bank of Detroit, 759 F.2d 542, 544 (6th Cir. 1985) (quoting *Stevens v. Lowder*, 643 F.2d 1078, 1080 (5th Cir. 1981)); *see also Carter v. Berger*, 777 F.2d 1173, 1176 (7th Cir. 1985) (In RICO case, "an indirectly injured party should look to the recovery of the directly injured party, not to the wrongdoer, for relief."). The RICO action, like plaintiffs' Section 10(b) claim, is a corporate asset, and shareholders cannot bring it in their own names without impairing the rights of prior claimants to such assets.

We do not address the district court's further holding that plaintiffs have alleged only a single predicate act.

5. *Sanctions*

The injunction against further litigation involving Teltronics by plaintiffs or their attorneys has not been briefed on appeal. The record clearly justifies such relief, however. Plaintiffs and their attorneys seem to believe that if at first you don't prevail, sue, sue again. The time has come to stop this repetitive litigation. We therefore affirm the injunction.

The imposition of costs and attorney's fees under Rule 11, Fed. R. Civ. P., is not before us at this time, although appellants chose to brief the issue. When appellees moved to adjourn the briefing and argument of this appeal until the amount of such costs and fees was finally determined by the district court, appellants opposed on the ground that an appeal from such a determination might not be taken. Because we denied appellees' motion, the Rule 11 issue is clearly not before us.

Affirmed.

APPENDIX D—ORDER OF THE SECOND CIRCUIT DENYING REHEARING EN BANC FILED SEPTEMBER 9, 1986

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

Docket No. 86-7034

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the day of one thousand nine hundred and eighty-

MICHAEL M. RAND, JOHN COSTELLO, STEVEN J. COSTELLO, GREGORY T. FRESE, EDWARD LAVIN, PETER A. MILANO and VINCENT F. SERVELLO,

Plaintiffs-Appellants,

-v.-

ANACONDA-ERICSSON, INC., ERICSSON, INC., L.M. ERICSSON TELEPHONE COMPANY, NORDIC AMERICAN BANK, CITIBANK, N.A., PRICE-WATERHOUSE & CO., SULLIVAN & CROMWELL, RICHARD HOWE, RICHARD G. LYON, L. STANTON TOWNE, TELECOM EQUIPMENT CORP. and STEPHEN R. COHEN,

Defendants-Appellees.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the appellant MICHAEL M. RAND et al.

Appendix D

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereof.

s/ Elaine B. Goldsmith
Elaine B. Goldsmith
Clerk